Supreme Court, U.S.
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No. 99-1371

IN THE

Supreme Court of the United States

MORDECHAI GAL-OLIVER, *et al.*,

Petitioners,

v.

COUTTS BANK (SWITZERLAND) LTD.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

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RESTATEMENT OF QUESTIONS PRESENTED FOR REVIEW

1. Whether the Second Circuit Court of Appeals erred in affirming the dismissal of Petitioners' alleged federal securities and racketeering claims against Respondent pursuant to Rules 9(b) and 12(b) of the Federal Rules of Civil Procedure, where

(i) the allegations of the dismissed pleading failed to raise a "strong inference" of scienter on the part of Respondent, as required by the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), and otherwise failed to comply with the PSLRA's heightened pleading requirements; and

(ii) Petitioners' alleged RICO claims, which were based solely upon their allegations of securities fraud, were not only facially deficient but were also barred by the provisions of the PSLRA mandating that alleged acts of securities fraud no longer constitute "predicate acts" for the purposes of RICO enforcement.

STATEMENT PURSUANT TO RULE 29.6

Respondent, Coutts Bank (Switzerland) Ltd., is wholly owned by Natwest PLC, a publicly held company.

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STATUTORY PROVISIONS INVOLVED

Securities Exchange Act of 1934,
15 U.S.C. § 78u-4

* * *

(b) Requirements for securities fraud actions.

* * *

(2) *Required state of mind.* In any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

Racketeer Influenced and Corrupt Organizations Act,
18 U.S.C. § 1964

* * *

(c) . . . no person may rely upon any conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of Section 1962.

STATEMENT OF THE CASE

This Petition concerns an affirmance by the United States Court of Appeals for the Second Circuit of an order of the United States District Court for the Southern District of New York (Rakoff, J.) dismissing Petitioners' amended complaint pursuant to 9(b) and 12(b)(6) of the Federal Rules of Civil Procedure ("FRCP"). The affirmance has already been the subject of one petition for writ of certiorari to this Court filed by Petitioners' co-plaintiffs in the action, Rachamim Anatian and several limited liability companies under his control (collectively, the "Anatian Petitioners"). By that prior petition, the Anatian Petitioners had sought review of the affirmance on substantially the same bases as advanced by Petitioners here. *See* "Petition for Writ of Certiorari," Case No. 99-1037. By order dated February 28, 2000, this Court denied certiorari to the Anatian Petitioners.

In support of their present request for a writ of certiorari with respect to the same affirmance, Petitioners have failed to present any "compelling reason" why the Circuit's ruling should be reversed or modified, *see* Supreme Court Rule 10, or any substantive federal issue which would raise the Circuit's disposition "beyond the academic or episodic." *See Rice v. Sioux City Memorial Park Cemetery*, 349 U.S. 70, 74 (1954); *Layne & Bowler Corp. v. Western Well Works, Inc.*, 261 U.S. 387, 393 (1923) ("it is very important that we be consistent in not granting the writ of certiorari except in cases involving principles the settlement of which is important to the public as distinguished from that of the parties, and in cases where there is a real and embarrassing conflict of opinion and authority between the circuit courts of appeal"). Petitioners cite no conflicts in the existing federal law regarding the dismissal of federal securities or

racketeering claims, nor do they cite any error in the Circuit's formulations of federal tort principles as they relate to the dismissed claims. Indeed, Petitioners concede that "the Second Circuit issued what, on its face, appears to be a proper statement of law." Petition at 11.

At its heart, the Petition is nothing more than Petitioners' attempt to reargue the Circuit's disposition solely on the basis that the Circuit allegedly made a "deliberate decision" to rule against them, a charge which is at best "sour grapes" and at worst an unfounded accusation of judicial misconduct. As set forth herein, there was nothing in the slightest bit "improper," "collusive" or "shocking" about the Second Circuit's review and interpretation of the record which led to the affirmance. Nor have Petitioners pointed to any error which would have had a material effect on the affirmance. Thus, even if this Court were willing to entertain a reargument of the Circuit's decision, dismissal of the amended complaint at issue would nevertheless remain entirely appropriate. The Petition should therefore be denied.

A. Background

This action involves a $2,000,000 loan made in 1996 by Respondent Coutts Bank (Switzerland) Ltd. f/k/a Coutts & Co AG ("Coutts"), a British private bank, to Mordechai and Margaret Gal-Oliver (collectively, "Petitioners"). Appendix at 11a.[1] The loan to Petitioners (the "Loan") was evidenced by a written "facility letter" issued by Coutts and a promissory note jointly executed by Petitioners. (A 221-222).

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1. Citations to "Appendix at __a" are to the pages of the Appendix attached to the Petition. Citations to "(A__)" are to the pages of the Joint Appendix filed in the Second Circuit.

Petitioners' repayment obligations under the note were secured by a written security agreement in which Petitioners pledged to Coutts "all assets" held at the bank. (A 218-219).

Upon drawing the full proceeds of the Loan in June 1996, Petitioners maintained $1,000,000 thereof in an interest bearing account at Coutts and accepted $1,000,000 in cash proceeds from the bank. Petitioners used the latter sums to defray their living expenses and to purchase stock in an enterprise known as Global Systems Network, Inc. ("GSN"), of which Mr. Gal-Oliver was Chief Operating Officer.

In June 1997, Petitioners failed to make certain interest payments due to Coutts and thus defaulted on the Loan. In accordance with Petitioners' written pledge, Coutts foreclosed on Petitioners' assets held by Coutts, including Petitioners' GSN shares (the "GSN Shares") which were on deposit with the bank. Thereafter, in August 1997, Coutts initiated a summary collection proceeding against Petitioners in the Supreme Court of the State of New York, County of New York (the "State Court Action") to recover the balance of the Loan outstanding at the time of suit. This summary proceeding ultimately resulted in a judgment entered against Petitioners in the full amount sought by Coutts. That judgment has now been affirmed by the Appellate Division, First Department of the New York State Supreme Court, and rehearing has been denied.

The federal action which is the subject of this Petition arose soon after Coutts commenced the State Court Action, when Petitioners commenced the federal action at issue here (the "District Court Action"). The gravamen of their complaint was that Coutts had allegedly breached certain

oral loan commitments to the Anatian Petitioners which allegedly had a deleterious effect on GSN's ongoing operations. As a result of those alleged breaches by Coutts of its obligations to the Anatian Petitioners, the Petitioners here claimed that they should be forgiven any obligation to repay their Loan. As a means of invoking the subject matter jurisdiction of the federal courts to hear that state law dispute (and to avoid litigating such issues in the State Court Action), Petitioners alleged further that Coutts' failure to follow through with its alleged collateral obligations to the Anatian Petitioners constituted a violation of several federal regulatory statutes, including 15 U.S.C. § 78j, 17 C.F.R. § 240.10b-5 ("Rule 10b-5") and Sections 1962 (a), (c) and (d) of the Racketeer Influenced and Corrupt Organizations Act (the "RICO Statute").

B. The Amended Complaint

Petitioners' amended complaint against Coutts (the "Amended Complaint"), which was the pleading ultimately dismissed by the District Court, is included at pages A 33-A 68 of the Joint Appendix submitted to the Second Circuit. The pleading consists of seven designated causes of action against Coutts. Its *ad damnum* clause requests compensatory and punitive damages from Coutts in excess of $60 million.

In the pleading, Petitioners admitted that they had executed the note and accepted the Loan from Coutts pursuant to the written facility letter. Petitioners further conceded that the Loan was secured by their written pledge of assets held at Coutts, including the GSN Shares. Notwithstanding the existence of these integrated

agreements, Petitioners alleged that certain officers of Coutts (referred to in the Amended Complaint as the "Coutts Representatives") orally represented to them, at some unspecified time, that GSN's stock "would rise precipitously" in value. Petitioners further alleged that they relied upon these representations as to the value of GSN's shares, and not their own familiarity with the company in which Mr. Gal-Oliver served as a principal, when determining whether to accept the $2,000,000 Loan and/or to use $700,000 of the proceeds thereof to purchase the GSN Shares.

Thus, as two claims in the District Court Action (the "10b-5 Claims"), Petitioners alleged that Coutts had intentionally misled them as to the value of the GSN Shares purchased entirely with Coutts' funds. This "fraud" in inducing the purchase of that stock, Petitioners contended, constituted a violation of Rule 10b-5. As two additional claims (the "Civil RICO Claims"), Petitioners alleged that these very same activities to (*i.e.*, an inducement to purchase the GSN Shares) coupled with the use of interstate mails and wires constituted violations of the RICO Statute.

C. The Dispositions Below

Coutts moved before the District Court to dismiss Petitioners' 10b-5 Claims and the Civil RICO Claims on the grounds that neither stated a claim upon which relief could be granted. Coutts also requested that the District Court decline to exercise supplemental jurisdiction to hear any of Petitioners' state law claims alleged in the Amended Complaint. The District Court heard extended oral argument of Coutts' dismissal motion in February 1998. The District

Court thereafter dismissed both the 10b-5 Claims and the Civil RICO Claims with prejudice and without leave to replead and declined supplemental jurisdiction over the remaining claims in deference to the State Court Action. With respect to Petitioners' alleged federal claims for relief, the District Court stated,

> These allegations [of the Amended Complaint] might more naturally be read to describe a fraud on the Coutts Bank than a fraud by it. But assuming *arguendo* that plaintiffs' allegations, read most favorable to them, make out State claims of fraud, contractual breach and the like against Coutts, they still fail to state a federal cause of action.
>
> * * *
>
> Here, the fraudulent misrepresentation on which plaintiffs chiefly rely — relating to the authority of Coutts Representatives to evade or override Coutts' internal loan requirements and to their failure to make good on their loan commitments [to Mr. Anatian] — do not pertain to any securities involved in a purchase or sale, and cannot support a claim for securities fraud. While the alleged misrepresentations regarding the value of plaintiffs' stock pledged as collateral might in some circumstances state a securities fraud, here there is no non-conclusory allegation that the plaintiffs were somehow deceived as to the true value of their own stock. Rather, despite some broad language in the Complaints, the only well-

> pleaded victim of the alleged misrepresentations is, if anyone, the Coutts home office, and so there is no fraud on the plaintiffs.
>
> Moreover, despite the inordinate length of these Amended Complaints, nowhere do they come close to meeting the particularity requirements of Rule 9(b) . . . Nor do they meet the particularity and intent requirements imposed by the Private Securities Reform Act of 1995. Given the length of the Complaints and the fact that plaintiffs have previously amended them, it cannot be reasonably supposed that plaintiffs could cure these deficiencies through further amendments.
>
> Accordingly, the securities fraud claims must be dismissed with prejudice. The RICO claims, suffering from similar Rule 9(b) infirmities, must likewise be dismissed. Appendix at 13a-15a (citations omitted).

On appeal, the Second Circuit affirmed the District Court's dismissal of Petitioners' alleged federal claims, stating as follows:

> Even if plaintiffs' allegations were true, the purported misrepresentations as to the authority of the Coutts representatives to loan money in excess of the bank's lending requirements and the failure to carry out the loan commitment [to Mr. Anatian] do not pertain to the purchase or sale of a security. The district court properly rejected plaintiffs' attempt "to transform what are in essence breach of contract claims or breach of

fiduciary duty claims only tangentially involving securities into securities fraud claims." Plaintiffs' claim that Coutts deceived them by inflating the value of GSN stock in order to extend them more credit falls short of the mark. It is not sufficient to allege fraud in a transaction in which a security is a part. Therefore, we affirm the dismissal of the securities fraud claim.

In addition, we find that Judge Rakoff properly dismissed both the securities fraud and RICO claims for failure to plead fraud with particularity. Alleging that Coutts Bank made a sizeable loan with knowledge that it could not be repaid does not give rise to an inference of fraud. Nor were the RICO predicate acts of mail and wire fraud alleged with sufficient particularity. Even if we were to find that the time and content of those communications met the Rule 9(b) standard, plaintiffs' claim must be dismissed because they failed to allege how those statements were fraudulent. *Id.* at 6a-7a (citations omitted).

REASONS FOR DENYING THE WRIT

A. THE AMENDED COMPLAINT FAILED TO STATE A CLAIM FOR RELIEF UNDER RULE 10b-5

Under the heightened pleading requirements adopted in the PSLRA, a putative securities law claimant must "with respect to each act or omission alleged to violate [the anti-fraud provisions of the Securities Exchange Act of 1934], state with particularity facts giving rise to a *strong inference* that the defendant acted with the required state of mind."

15 U.S.C. § 78u-4(b)(2) (1998) (emphasis added). There can be little doubt that, under this pleading standard, which was intended to heighten the Circuits' existing standards, the Amended Complaint could not support the 10b-5 Claims.

At page 4 of their Petition, Petitioners set forth several facts which form the predicate for those claims:

1) Mr. Gal-Oliver, who was the Chief Operating Officer of GSN, had "few assets."

2) Notwithstanding its knowledge of Petitioners' alleged impecuniousness, Coutts advanced $2,000,000 of its own funds to facilitate, among other things, Petitioners' purchase of $700,000 in GSN Shares.

3) GSN later filed for bankruptcy protection, allegedly as a result of Coutts' non-fulfillment of oral obligations made to the Anatian Petitioners, thereby rendering GSN's stock "virtually worthless." Petition at 4.

Based on these allegations, Petitioners have sought an inference that, at the time Coutts advanced $2,000,000 to them, those officers who allegedly represented to Petitioners that GSN's stock "would rise precipitously" knew that their statements were false. Petition at 16.

As this Court stated in *Matsushita Elec. Indus. Co. v. Zenith Radio*, 475 U.S. 574, 596-97 (1986), if a defendant has no "rational economic motive to conspire, and if [its] conduct is consistent with other, equally plausible explanations, the conduct does not give rise to an inference

of a conspiracy." Following this Court's lead, Courts in the Second Circuit have been loathe to draw inferences of scienter which fraudulent or conspiratorial intent "defy logic" or otherwise defy "economic reason." *See, e.g., Shields v. Cititrust Bancorp, Inc.*, 25 F.3d 1124, 1127 (2d Cir. 1994) (dismissed 10b-5 claim was contrary to defendants' "economic self-interest"); *Laro, Inc., v. Chase Manhattan Bank*, 866 F. Supp. 132, 137 (S.D.N.Y.), *aff'd*, 60 F.3d 810 (2nd Cir. 1994).

In this case, despite requests by both the District Court and the Second Circuit, Petitioners failed to offer any explanation as to why their theory of Coutts' behavior made "economic sense." Why would Coutts lend Petitioners $2 million to purchase $700,000 in GSN stock, and obtain a pledge of such stock, if Coutts knew that the stock was overvalued? Clearly, if Coutts wanted to obtain the stock for its own account, it could have purchased the GSN Shares for far less than the very dear price of $2 million. Nor is it reasonable to infer that Coutts risked its own funds to earn relatively insignificant interest and fees on the Loan. *See, e.g., Chill v. General Elec. Co.*, 101 F.3d 263, 268 (2d Cir. 1996). The lack of any rational basis to infer that Coutts in fact advanced the Loan as a means of obtaining the GSN Shares for less than fair consideration led both the District Court and the Second Circuit to conclude that, if Petitioners had any claims against Coutts regarding an alleged "Coutts Commitment" to the Anatian Petitioners, such claims were for common law breach of contract, not securities fraud. Appendix at 6a, 13a-14a. In that regard, the courts have universally held that the failure to carry out a promise in connection with a securities action is a breach of contract, not a fraud. *See, e.g., Mills v. Polar Molecular Corp.*, 12 F.3d 1170, 1176 (2d Cir. 1993) (failure to carry

out promise in a securities transaction is normally a breach of contract and not a fraud); *Kramer v. Time Warner Inc.*, 937 F.2d 767, 776 (2d Cir. 1991) (collecting cases; plaintiff cannot transform state law breach of contract or fiduciary duty claim into securities fraud claim); *cf. Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 476 (1977) (breach of fiduciary duty, without more, does not constitute violation of Rule 10b-5).

B. THE AMENDED COMPLAINT FAILED TO STATE A CLAIM FOR RELIEF UNDER THE RICO STATUTE

The alleged basis for Petitioners' Civil RICO claims appeared in paragraph 119 of the Amended Complaint:

> Coutts entered into a scheme to defraud Plaintiffs, as set forth in detail at paragraphs 37, 48-50, 54, 67 and 70, above. In particular, in order to induce Plaintiffs to sign the Facility Agreements, to pledge stock to Coutts, and to pay the interest differential, Coutts represented to Plaintiffs it would make the loans, described and represented as the Coutts Commitment, to the seven LLCs; that the New York Office of Coutts had the authority to make such loans and to release the funds thereunder to Plaintiffs without the consent of any other entity or person, including, but not limited to the London office of Coutts; and that that the [GSN Shares] had a value far greater than its actual value.

(A 57). The Amended Complaint further contained "boilerplate" allegations that Coutts mailed account statements to Borrowers and made telephone calls to them

to "confirm" the "frauds" (A 58); that the "foregoing" predicate acts constitute the required "continuity plus relationship" (A 59); and that Coutts may engage in other and further illicit "business practices" in the future. (*Id.*). As to these claims, the Second Circuit affirmed their dismissal "for the reasons set forth in the District Court," *i.e.*, for failure to state a claim for relief with the particularly required by FRCP 9(b). Appendix at 7a.

Petitioners' sole basis for challenging the affirmance is their feigned "shock" that the Circuit dismissed "claims under Section 1962(c)," which Petitioners now purport to have abandoned in their appeal to the Circuit. Petition at 12. Even assuming that Petitioners had in fact abandoned that claim, the "error" of the Second Circuit in no way impacts Petitioners' failure to plead a federal claim for relief under the RICO Statute. The only alleged "predicate act" which pertains specifically to Petitioners' case is their allegation that Coutts "misrepresented" "that the [GSN Shares] had a value far greater than [their] actual value." (A 57). Yet, securities fraud is clearly no longer cognizable as a predicate act for purposes of a civil RICO claim. Section 1964(c), as amended in the PSLRA, expressly states that "no person may rely upon any conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of Section 1962." *See* 18 U.S.C. § 1964(c) (1999).[2]

2. Petitioners' Civil RICO Claims were hopelessly insufficient in other material respects. For example, the Amended Complaint summarily alleged that Coutts was an "enterprise" under 18 U.S.C. §§ 1961(4), 1962. (A 56). The mere allegation that Coutts engaged in "fraud" in the conducting of its operations did not, however, transform Coutts into an "enterprise." *See Riverwoods Chappaqua Corp. v. Marine Midland Bank, N.A.*, 30 F.3d 339, 344 (2d Cir. (Cont'd)

C. THE DISTRICT COURT DID NOT ABUSE ITS DISCRETION BY DENYING PETITIONERS LEAVE TO REPLEAD THEIR FEDERAL TORT CLAIMS

The only other "error" addressed in the Petition is whether the District Court abused its discretion by denying Petitioners leave to replead their facially defective federal claims. In that regard, this Court has held that district courts have sound discretion to grant or deny leave to replead a dismissed complaint. *Foman v. Davis*, 371 U.S. 178, 182 (1962). Whether or not leave to replead has been requested, the "futility" of any further amendments clearly constitutes a valid ground for district courts to deny leave to replead or amend. *Id.* at 1802; *F.D.I.C. v. Bathgate*, 27 F.3d 850, 874-75 (3d Cir. 1994); *Williams v. Little Rock Mun. Water Works*, 21 F.3d 218, 226 (8th Cir. 1994); *Hutsell v. Sayre*, 5 F.3d 996, 1006 (6th Cir.), *cert. denied*, 510 U.S. 1119 (1993). In denying leave to replead in this case, the District Court was

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(Cont'd)

1994) (RICO violation insufficiently alleged where the enterprise "consists merely of a corporate defendant associated with its own employees or agents carrying on the regular affairs of the defendant"). Nor did the Amended Complaint establish a "pattern" of activity on the part of Coutts. In the end, the "frauds" alleged against Coutts, even if true, were part of a single transaction with a finite purpose and with no threat of continuity against Petitioners or anyone else. *See Klehr v. A.O. Smith Corp.*, 521 U.S. 179 (1997) (RICO statute requires at least two acts of racketeering); *H. J. Inc. v. Northwestern Bell Telephone*, 492 U.S. 229 (1989). Nor was there any basis for inferring that the predicate acts alleged by Petitioners, namely "mail" or "wire fraud," would continue unabated. *GICC Capital Corp. v. Technology Fin. Group*, 67 F.3d 463, 466 (2d Cir. 1995) ("It defies logic to suggest that a threat of continued looting exists when, as plaintiff admits, there is nothing left to loot").

not faced with a party's inadvertent omission of a few material allegations from its pleading or the inartful drafting of a claim. (Petitioners could hardly be accused of leaving anything out of their Amended Complaint.) Rather, as set forth herein, the hundreds of allegations in the Amended Complaint, even if true, simply did not give rise to claims for relief under the federal securities laws or the RICO Statute. The District Court specifically noted that the Amended Complaint, although "inordinately long," did not "come close" to meeting the exacting pleading requirements of the PSLRA or FRCP 9(b). Appendix at 14a. Nor would Petitioners ever "come close" to creating a federal fraud with allegations of a $2,000,000 loan made to an officer of a corporation to facilitate the purchase of $700,000 in overvalued stock in that corporation. As such, both the Second Circuit and the District Court were correct in concluding that it could not "be reasonably supposed" that leave to replead would cure the myriad of deficiencies in the Amended Complaint.

CONCLUSION

As set forth above, Petitioners have highlighted nothing in the Second Circuit's affirmance which represents in any way a departure from well-established legal principles regarding the dismissal of conclusory allegations of securities fraud and racketeering. Thus, the Petition for writ of certiorari should be denied.

Respectfully submitted,

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